



National Credit Union Administration
REGION I

Charter 21630

**Letter of Understanding and Agreement
By and Between
The National Credit Union Administration
and
The Northeastern Engineers Federal Credit Union**

This Letter of Understanding and Agreement sets forth significant adverse conditions identified by the National Credit Union Administration as a result of its examination of the Northeastern Engineers Federal Credit Union, dated February 28, 1999, and the agreements reached with the credit union's officials to resolve them.

The significant adverse conditions were:

1. **Management.** The board of directors did not resolve critical areas of concern identified in one or more prior examination reports, including your real estate lending program and asset-liability management. Other management concerns include poor internal controls, regulatory violations, consumer compliance violations, lending violations, and improperly worded notification of the 1998 annual meeting.
2. **Real Estate Lending Program.** Management does not underwrite real estate loans in conformity with traditional secondary market standards and guidelines. The real estate loan portfolio, representing 89 percent of total assets as of February 28, 1999, contains unmeasured market, interest rate, liquidity, and operational risk.
3. **Asset Liability Management.** Management does not have an acceptable asset-liability management program in place to monitor interest rate risk exposure on the balance sheet, and to address the liquidity and profitability needs of the credit union.
4. **Full and Fair Disclosure.** Management significantly underfunded the Allowance For Loan Losses account based on potential losses in the consumer and real estate loan portfolio.
5. **Supervisory Committee Annual Audit.** Your supervisory committee did not ensure the timely completion of the 1997, and 1998, annual audit.
6. **Year 2000 Compliance Progress.** The board of directors failed to fully test critical software systems for Year 2000 readiness and did not renovate or test hardware to ensure continued operation into the next millennium.

7. **Capital Adequacy.** Your credit union does not have sufficient capital and net capital considering the high concentration of long term real estate loans and the significant risks associated with your real estate loan portfolio.
8. **Internal Controls.** The credit union's system of internal controls is inadequate to ensure that: (a) segregation of duties exists, and (b) that record keeping is accurate and up to date.

The agreed upon actions and time frames are:

1. Management

- a) The board of directors will not grant any loans to individuals not in your credit union's current field of membership and that violate any applicable provision of NCUA Rules and Regulations. Take this action **immediately**.
- b) The credit union will assess the same penalties, apply the same fees, and apply the same policies and procedures on the accounts of employees, officials, and related members that the credit union assesses/applies to other members. Take this action **immediately**.
- c) Obtain a legal opinion regarding whether the use of a single attorney for both parties at a credit union real estate closing is a conflict of interest, **by no later than June 30, 1999.**
- d) The board of directors will **immediately** take the following actions regarding your 1999, and all future annual membership meetings and elections of officers:
 1. Select a nominating committee in accordance with your by laws;
 2. Provide proper notice of the date, time, and place of the annual meeting to your membership.
 3. Maintain full and complete records of each annual membership meeting.
 4. Comply with any other provisions of your bylaws regarding annual meetings and elections of officers.
- e) **Immediately** cease the practice of refinancing delinquent loans until you adopt appropriate policies and procedures for sound loan refinances.

- f) Control operations by holding management (board of directors, committees, and compensated management staff) accountable for performing the actions required in this document and take action to ensure violations of applicable regulations do not occur, immediately and ongoing. **Take this action immediately.**
- g) Provide both the Chief Executive Officer (treasurer) and manager with written performance reviews that will focus on compliance with this Letter of Understanding
by September 30, 1999, and every quarter thereafter.

2. Real Estate Lending Program / Lending Policies and Practices

- a) Engage the services of your chosen Mortgage Loan Evaluator to complete a detailed analysis on the quality, salability, and value of your mortgage loan portfolio. Your Mortgage Loan Evaluator will provide you with a written report outlining findings and recommendations for corrective action. **Take this action by no later than June 1, 1999, and complete this action by August 31, 1999.**
- b) Place a moratorium on mortgage lending until you complete item ~~2a and 2b~~ *2c* above, and implement all recommendations provided for the mortgage loan evaluation. **Take this action immediately.**
- c) Prepare, adopt, and implement revised lending policies and practices that cover all the types of loans offered by your credit union. Follow the Document of Resolution under the heading "Lending Policies and Practices" for the minimum items to address in your revised lending policy. **Complete your consumer loan policies by July 31, 1999. Complete your real estate loan policies by November 30, 1999. The moratorium on mortgage lending remains in effect until you adopt your revised real estate lending policies.**

3. Asset-Liability Management Program

- a) Engage the services of your chosen asset-liability management professional via a written agreement for work to commence **by no later than June 15, 1999,** to help you implement a suitable asset-liability management program considering your excessive concentration of real estate loans and your source of funding for these loans.

b) Develop, adopt, and implement an acceptable asset-liability management program to monitor and address your balance sheet's interest rate risk exposure, the mismatch between rate-sensitive assets and liabilities, and your liquidity and profitability needs. **Take this action by September 30, 1999.**

4. Full and Fair Disclosure

a) Increase the Allowance For Losses via a charge to Provision For Loan Loss Expense by \$1,324,700 to comply with Full and Fair Disclosure. **Take this action by no later than June 30, 1999.**

b) Establish a method for funding the ALL account that complies with NCUA Letter 126 and Accounting Bulletin 92-1 by **July 13, 1999**. **The methodology shall include an individual classification of collection problem loans, a classification of the real estate loan portfolio, and a classification of the remaining loan portfolio based on prior loan loss experience.**

c) Monitor the ALL monthly starting June 30, 1999, and ensure that you adequately fund the ALL to provide for full and fair disclosure. The board of directors will incorporate the funding analysis into the monthly board minutes.

5. Supervisory Committee Annual Audit / Compliance Review

a) Obtain a CPA opinion audit covering the period from January 1, 1998, through and including December 31, 1998. **Complete this action by no later than July 31, 1999.**

b) Ensure that the CPA's engagement letter complies with Part 701.12(d) of NCUA Rules and Regulations. **Complete this action by no later than July 6, 1999.**

c) The supervisory committee will engage, **by no later than June 30, 1999**, the services of an independent third party to perform an annual compliance review covering your credit union's extent of compliance with NCUA Rules and Regulations, consumer compliance regulations, and other applicable laws and regulations. **Complete this action by no later than December 31, 1999, and annually thereafter.**

6. Capital Adequacy

- a) Develop, adopt, and implement a capital growth and maintenance plan covering a minimum two year period.
- b) Establish and adhere to the following schedule of benchmarks and time frames (as a minimum), for the Net Capital to Asset Ratio, assuming you will attain your current Return on Assets excluding Provision For Loan Loss Expense and achieve stable Asset Growth

<u>Date</u>	<u>Net Capital Ratio</u>
6/30/99	2.1%
9/30/99	2.2%
12/31/99	2.3%
3/31/2000	2.4%

7. Year 2000 Compliance Issues

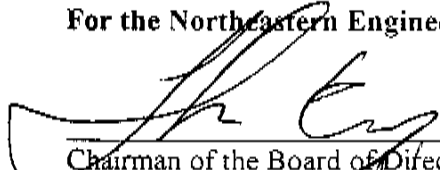
- a) Complete renovation of all hardware and software **by no later than August 1, 1999.**
- b) Adopt test scripts, perform compliance testing, review testing results, and formally approve the adequacy of testing in the monthly board minutes. Ensure that testing validation involves the credit union personnel, the software vendor, and an objective independent party (e.g., auditor, CPA, etc.)
Complete these actions by no later than August 31, 1999.
- c) Develop and adopt Y2K contingency plans for Liquidity Funding and Business Resumption **by no later than July 13, 1999.**
- d) Begin the validation phase of the Business Resumption Contingency Plan by obtaining a review of the plan by a qualified independent party **by no later than June 30, 1999.**
- e) Begin the second phase of the validation process by initiating testing of the Business Resumption Contingency Plan **by no later than July 31, 1999.**

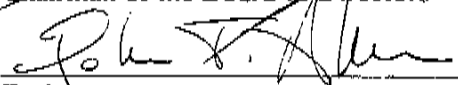
8. Internal Controls

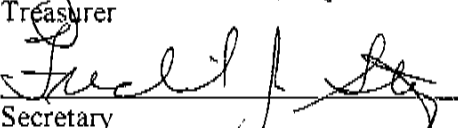
- a) The board of directors shall establish appropriate cash control procedures in writing **by no later than July 13, 1999**, ensuring adequate segregation of duties.
- b) The supervisory committee shall ensure that it performs an independent review of the reporting and record keeping requirements for Bank Secrecy Act compliance. **Complete this action by no later than September 30, 1999, and annually thereafter.**
- c) The supervisory committee shall perform quarterly reviews of internal controls, including verifications on inactive accounts, as part of an on-going program. **Take this action by September 30, 1999, and quarterly thereafter.**

The Regional Director will publish this Letter of Understanding and Agreement. It remains in effect until canceled by mutual agreement of the Northeastern Engineers Federal Credit Union and the National Credit Union Administration or until it is replaced by another Letter of Understanding and Agreement.

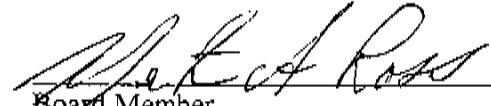
For the Northeastern Engineers Federal Credit Union:

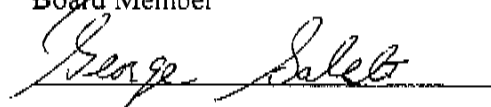

Chairman of the Board of Directors
Date 6/27/99

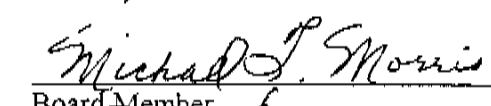

Treasurer
Date 6-27-99

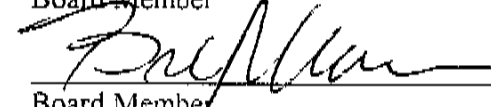

Secretary
Date 6-27-99

Board Member
Date _____



Board Member
Date 6-27-99

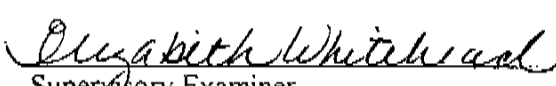

Board Member
Date 6/27/99

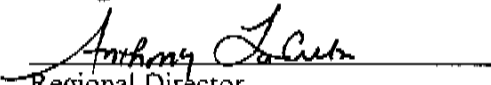

Board Member
Date 6/27/99


Board Member
Date 6/27/99

For the National Credit Union Administration:


Examiner
Date 6/28/99


Supervisory Examiner
Date 6/28/99


Regional Director
Date 6.30.99